

STATE OF CALIFORNIA

Report to the California State Legislature

PROPERTY TAX APPORTIONMENTS

Calendar Year 2005



STEVE WESTLY
California State Controller

December 2006



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California State Controller

December 8, 2006

To the Members of the State Legislature
and the People of California:

I am pleased to present the Property Tax Apportionments report for calendar year 2005. This report, prepared pursuant to *Government Code* Section 12468, is intended to help mitigate problems associated with the counties' apportionment and allocation of property tax revenues.

The audits completed by the State Controller's Office in 2005 found the audited counties to be generally in compliance with the legal requirements for allocating property tax revenues. However, this report notes specific problem areas relative to individual counties.

I hope you find the report informative and useful for future policy decisions.

Sincerely,

Original signed by

STEVE WESTLY

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Overview

Introduction

This report presents the results of 19 audits of county property tax apportionments and allocations completed by the State Controller's Office (SCO) in calendar year 2005. The following counties were audited: Butte, Calaveras, Fresno, Humboldt, Lassen, Marin, Modoc, Monterey, Napa, Orange, Placer, Plumas, San Benito, San Bernardino, San Luis Obispo, Santa Clara, Stanislaus, Tehama, and Ventura. *Government Code* Section 12468 requires that such audits be conducted periodically for each county according to a prescribed schedule based on county population. The purpose of the audits is to help mitigate problems associated with property tax apportionment and allocation.

Except for the findings and recommendations noted in this report, all audited counties complied with the requirements for the apportionment and allocation of property tax revenues.

Eight of the counties audited—Butte, Lassen, Marin, Placer, Plumas, San Luis Obispo, Tehama, and Ventura—had no reportable findings.

Background

After the passage of Proposition 13 in 1978, the California State Legislature enacted new methods for allocating and apportioning property tax revenues to local government agencies and public schools. The main objective was to provide local agencies with a property tax base that would grow as assessed property values increase. These methods have been further refined in subsequent laws passed by the Legislature.

One key law was Assembly Bill 8, which established the method of allocating property taxes for fiscal year 1979-80 (base year) and subsequent fiscal years. The methodology is commonly referred to as the AB 8 process or the AB 8 system.

Property tax revenues that local governments receive each fiscal year are based on the amount received the prior year plus a share of the property tax growth within their boundaries. Property tax revenues are then apportioned and allocated to local agencies and schools using prescribed formulas and methods defined in the *Revenue and Taxation Code*.

The AB 8 process involved several steps, including the transfer of revenues from schools to local agencies and the development of the tax rate area annual tax increment growth factors (ATI factors), which determine the amount of property tax revenues allocated to each entity (local agency and school). The total amount allocated to each entity is then divided by the total amount to be allocated to all entities to determine the AB 8 factor (percentage share) for each entity for the year. The AB 8 factors are computed each year for all entities using the revenue amounts established in the prior year. These amounts are adjusted for growth annually using ATI factors.

Subsequent legislation has removed revenues generated by unitary and operating nonunitary property from the AB 8 system. This revenue is now allocated and apportioned under a separate system.

Other legislation established an Educational Revenue Augmentation Fund (ERAF) in each county. Most local government agencies are required to transfer a portion of their property tax revenues to the ERAF. The fund is subsequently allocated and apportioned by the county auditor according to instructions received from the local superintendent of schools or chancellor of community colleges.

Taxable property includes land, improvements, and other properties that are accounted for on the property tax rolls, which are primarily maintained by the county assessor. Tax rolls contain an entry for each parcel of land, including parcel number, owner's name, and value. The types of property tax rolls are:

- *Secured Roll*—Property that, in the opinion of the assessor, has sufficient value to guarantee payment of the tax levies and that, if unpaid, can be satisfied by the sale of the property by the tax collector.
- *Unsecured Roll*—Property that, in the opinion of the assessor, does not constitute sufficient “permanence” or have other intrinsic qualities to guarantee payment of taxes levied against it.
- *State-Assessed Roll*—Utility properties, composed of unitary and nonunitary value, assessed by the State Board of Equalization.
- *Supplemental Roll*—Property that has been reassessed due to a change in ownership or the completion of new construction, where the resulting change in assessed value is not reflected in other tax rolls.

Audit Program

The property tax audit program began on July 1, 1986, under *Revenue and Taxation Code* Section 95.6 (now *Government Code* Section 12468). The statute mandates that the State Controller periodically perform audits of the allocation and apportionment of property tax revenues by counties and make specific recommendations to counties concerning their property tax administration. However, the State Controller's authority to compel resolution of its audit findings is limited to those findings involving an overpayment of state funds.

Overpayment of state general fund money is recoverable by the State under several provisions of law (e.g., *Education Code* Section 42237.7 et seq., and *Government Code* Section 12420 et seq.). In addition, the State Controller has broad authority to recover overpayments made from the State Treasury. If an audit finds overpayment of state funds, and the state agency that made or authorized the payment does not seek repayment, the SCO is authorized to pursue recovery through a variety of means (e.g., *Government Code* Sections 12418 and 12419.5). The specific remedy employed by the SCO depends on the facts and circumstances of each situation.

To carry out the mandated duties of the State Controller, the SCO developed and implemented a comprehensive audit program that includes, but is not limited to, a detailed analysis of past and current requirements of property tax laws and an examination of property tax records, processes, and systems at the county level.

These property tax apportionment audits have identified and aided in the correction of property tax underpayments to public schools. The underallocation of property taxes by individual counties to their public schools results in a corresponding overpayment of state funds to those schools by the same amount. This, in turn, causes public schools in other counties to receive less state funding because the total funds available are limited. Subsequent legislation forgave some counties for underpayments to schools without requiring repayment or assessment of penalties. However, the legislation required that the cause of the underallocations, as identified by the audits, be corrected.

Audit Scope

Each audit encompasses an evaluation of a county's property tax apportionment methodology, allocation procedures, and compliance with applicable laws and regulations. The auditors used procedures considered necessary to provide a basis for reporting on the areas examined. In conducting the audits, the auditors focused on the following areas to determine if:

- The apportionment and allocation of the annual tax increment (ATI) was in accordance with *Revenue and Taxation Code* Sections 96 through 96.5;
- The methodology for redevelopment agencies' base-year calculations and apportionment and allocation of the ATI was in accordance with *Revenue and Taxation Code* Sections 96.4 and 96.6 and *Health and Safety Code* Sections 33670 through 33679;
- The effect of jurisdictional changes on base-year tax revenues and the ATI was in accordance with *Revenue and Taxation Code* Section 99;
- The apportionment and allocation of property tax revenues from supplemental assessments was in accordance with *Revenue and Taxation Code* Sections 75.60 through 75.71;
- The apportionment and allocation of state-assessed unitary and operating nonunitary property taxes was in accordance with *Revenue and Taxation Code* Section 100;
- The computation and apportionment of property tax revenues to low- and no-tax cities was in accordance with *Revenue and Taxation Code* Section 98;
- The computation and collection of local jurisdictions' property tax administrative costs was in accordance with *Revenue and Taxation Code* Sections 95.2 and 95.3;

- The computation and apportionment of property tax revenues to the ERAF was in accordance with *Revenue and Taxation Code* Sections 97 through 97.3; and
- For eligible counties, the computation of the county credit against the county's ERAF shift was in accordance with *Revenue and Taxation Code* Sections 97.3(a)(5) and 97.36.

Conclusion

The property tax allocation and apportionment system is generally operating as intended. In the interest of efficiency and cost control for both the counties and the State, we submit the Summary of Findings and Recommendations in this report to assist in initiating changes that will help improve the system.

Summary of Findings and Recommendations

Introduction

Except for the findings and recommendations cited in this report, the audit reports issued in 2005 indicated that the counties complied with the legal requirements for the apportionment and allocation of property tax revenues. However, problem areas were identified and are described below. Recommendations to resolve the problems are included with the individual county findings.

Unresolved Prior Audit Findings

As part of the audit process, auditors review the prior audit report to determine which issues, if any, require follow-up action. Auditors perform procedures to determine whether the county has resolved previously noted findings, and they restate in the current audit any unresolved prior audit findings.

We restated findings for eight counties that had not resolved prior audit findings.

Computation of Annual Tax Increment Factors

The *Revenue and Taxation Code* requires that each jurisdiction in a tax rate area (TRA) must be allocated property tax revenues in an amount equal to the property tax revenues allocated to it in the prior fiscal year. The difference between this amount and the total amount of property tax assessed in the current year is known as the annual tax increment. The computation of the annual tax increment results in a percentage that is used to allocate growth in assessed valuation to a county's local government jurisdictions and schools from the base year forward. *Revenue and Taxation Code* Sections 96 through 96.5 prescribe this methodology. (Some exceptions to this allocation are contained in the *Revenue and Taxation Code* for specified TRAs.)

We noted findings for four counties in this area.

- One county continued to have base year revenue and factor computation errors that had not been corrected.
- One county computed tax increment that did not agree with the 1% change in secured and unsecured assessed values; also, the gross levy in the AB 8 system was greater than 1% of secured and unsecured assessed values.
- One county excluded the state-assessed local utility roll from increment calculations for two years, which resulted in understated increment and gross revenue to most of the county's taxing entities.
- One county continued to annually recompute ATI factors for all jurisdictions in all tax rate areas, causing the factors to be inconsistent from year to year.

Jurisdictional Changes

Revenue and Taxation Code Section 99 prescribes the procedures the county must perform in order to make adjustments for the apportionment and allocation of property taxes resulting from changes in jurisdictional controls or changes in responsibilities of local government agencies and schools. The statute requires the county to prepare specific documentation that takes into consideration services and responsibilities.

We noted findings for three counties in this area.

- One county failed to follow the master tax agreement when making revenue exchanges for city annexations.
- One county failed to complete revenue transfers and incorrectly computed TRA factor adjustments.
- One county failed to transfer unsecured values from existing TRAs to resulting TRAs, failed to adjust prior year assessed valuation for the homeowner's exemption when transferring assessed values from existing TRAs to resulting TRAs, and failed to properly compute revenue exchange calculations to agree with agreements.

Supplemental Property Tax Apportionments

When a revaluation of property occurs during the fiscal year due to changes in ownership or completion of new construction, supplemental taxes are usually levied on the property. *Revenue and Taxation Code* Sections 75.70, 75.71, and 100.2 provide for the apportionment and allocation of these supplemental taxes.

We noted findings for four counties in this area.

- One county failed to retain supporting documentation for the calculation of supplemental property tax apportionment factors.
- One county revised, but failed to implement, supplemental property tax apportionment for two years.
- One county included redevelopment agencies in its supplemental apportionment system.
- One county included supplemental apportionment factors for RDAs, RDA pass-throughs, and its unitary and operating nonunitary system in the supplemental apportionment system.

Supplemental Property Tax Administrative Fees

Once they adopt a method of identifying the actual administrative costs associated with the supplemental roll, counties are allowed to charge an administrative fee for supplemental property tax collections. This fee is not to exceed 5% of the supplemental taxes collected.

We noted findings for four counties in this area.

- One county continued to not fully document costs and computed the 5% reimbursement on total collections, including costs and penalties.

- One county computed the 5% reimbursement on total collections, including costs and penalties.
- One county charged the 5% fee to basic levy districts and the ERAF and computed the 5% reimbursement on total collections, including costs and penalties.
- One county failed to document supplemental property tax administrative costs.

Redevelopment Agencies

The legal requirements for the apportionment and allocation of property tax to redevelopment agencies are found in *Revenue and Taxation Code* Sections 96.4 and 96.6 and *Health and Safety Code* Sections 33670 through 33679. California community redevelopment law entitles a community redevelopment agency to all of the property tax revenue realized from growth in values since the redevelopment project's inception, with specified exceptions.

We noted findings for three counties in this area.

- When current year assessed values decreased below base year values, one county charged the RDA for the decrease and distributed it to the applicable agencies. When the results of pass-through calculations exceeded available increment, the county charged the RDA and distributed the charge to the applicable agencies.
- One county was unable to substantiate base year values for one RDA project and did not transfer all parcels for the project to the project TRAs.
- One county included the ERAF in the allocation of RDA pass throughs.

Unitary and Operating Nonunitary Property Taxes

The process for allocating and apportioning property taxes from certain railroad and utility companies functions through the unitary and operating nonunitary tax system employed by the State Board of Equalization. Unitary properties are those properties on which the State Board of Equalization "may apply the principle of unit valuation in valuing properties of an assessee that are operated as a unit in the primary function of the assessee" (i.e., public utilities and railroads). The *Revenue and Taxation Code* further states, "Operating nonunitary properties are those that the assessee and its regulatory agency consider to be operating as a unit, but the board considers not part of the unit in the primary function of the assessee." *Revenue and Taxation Code* Section 100 prescribes the procedures counties must perform to allocate unitary and operating nonunitary property taxes beginning in fiscal year (FY) 1988-89.

We noted findings for six counties in this area.

- One county excluded RDAs from the calculation of excess unitary and operating nonunitary apportionment factors when assessed values increased by more than 2% over the prior year.
- One county improperly computed unitary and operating nonunitary apportionment factors. As a result, it understated revenue for one year and overstated revenue for two years.
- One county did not properly compute growth when assessed valuation increased by more than 2% over the prior year.
- One county remained unable to document the methodology it used to compute base unitary and operating nonunitary revenue amounts because its working papers were not available.
- One county had not adjusted apportionment factors for three years, although unitary and operating nonunitary assessed values increased by more than 2% over the prior year.
- One county continued to include in the AB8 apportionment system unitary and operating nonunitary assessed values in pre-1989 RDA base amounts. It used the same base values to compute the pre-1989 RDA base revenue in the unitary and operating nonunitary apportionment system. As a result, it understated pre-1989 RDA AB 8 revenue and overstated unitary and operating nonunitary revenue in the unitary and operating nonunitary apportionment system.

Property Tax Administrative Fees

Counties are allowed to collect from each appropriate jurisdiction that jurisdiction's share of the cost of assessing, collecting, and apportioning property taxes. *Revenue and Taxation Code* Section 95.3 prescribes the requirements for computing and allocating property tax administrative fees. The assessor, tax collector, and auditor generally incur county property tax administrative costs. The county is generally allowed to be reimbursed for these costs.

We noted findings for three counties in this area.

- One county improperly computed administrative cost allocation factors when the factors did not reconcile to the total combined factors for the AB 8 and unitary and operating nonunitary systems.
- One county improperly recorded allowable costs and understated offsetting revenues; as a result, it made errors in costs charged.
- One county computed the administrative cost reimbursement allocation for one year using costs from an incorrect year.

Educational Revenue Augmentation Fund

The legal requirements for the local agency shift of property tax revenues to the ERAF are contained in *Revenue and Taxation Code* Sections 97 through 97.3. Beginning in FY 1992-93, each local agency was required to shift an amount of property tax revenues to the ERAF using formulas prescribed by the *Revenue and Taxation Code*. The property tax revenues in the ERAF are subsequently allocated to schools and community colleges using factors supplied by the county superintendent of schools or chancellor of the California community colleges.

Since the passage of the ERAF shift requirements, the Legislature has enacted numerous bills that affect the shift requirements for various local government agencies. One bill of particular interest was AB 1589 (Chapter 290, Statutes of 1997). This bill primarily addressed three areas related to the ERAF shift: (1) ERAF shift requirements for certain county fire funds for FY 1992-93 (*Revenue and Taxation Code* Section 97.2(c)(4)(B)); (2) a special provision for counties of the second class when computing the ERAF shift amount for county fire funds in FY 1993-94 (*Revenue and Taxation Code* Section 97.3(c)(4)(A)(I)); and (3) ERAF shift requirements for county libraries for FY 1994-95 and subsequent years. After the passage of AB 1589, the State Controller requested advice from the California Attorney General regarding the application of Chapter 290. The Attorney General responded in May 1998.

The Attorney General advised that the amendment to *Revenue and Taxation Code* Section 97.2(c)(4)(B) significantly narrowed the scope of the exemption granted by the code section and was to be given retroactive application. The result is that many counties and special fire protection districts that were able to claim an exemption under the section as it formerly read lost the exemption retroactive to FY 1992-93. Consequently, those counties and special districts were required to shift additional funds to the county ERAF.

In response to the advice by the Attorney General, and noting the severe fiscal impact the loss of the exemption would have on local government agencies, the State Controller recommended that the Legislature consider restoring the exemption previously granted to fire protection districts and county fire funds that was eliminated as a result of Chapter 290, Statutes of 1997. Subsequently, the Legislature enacted AB 417 (Chapter 464, Statutes of 1999), restoring the exemption to fire districts.

We noted findings for six counties in this area.

- One county did not properly compute the city and county ERAF per capita computations for the audit period. As a result, it understated ERAF shifts; did not complete the reversal of the disaster relief adjustment resulting in understated ERAF shifts; and did not perform the required growth computations for one year, resulting in understated ERAF shifts for all agencies.
- One county still had not corrected the reversal of the disaster relief adjustment and improperly computed the ERAF shift amount for one year because the annual tax increment in the AB 8 system did not agree with the worksheet that computes the ERAF shift growth factor.

- One county completed the disaster relief adjustment for cities in FY 1999-2000 and for the county in FY 2001-02 instead of FY 1997-98. As a result, it understated ERAF shifts for the intervening years and improperly computed the county and cities' per capita ERAF adjustments as reductions to the ERAF shift, resulting in understated ERAF shifts.
- One county did not correct an error noted in the prior audit. As a result, it under- and overstated of the ERAF shift for various agencies.
- One county did not correct three findings noted in the prior audit and incorrectly computed growth for all but one year.
- One county did not correct the findings noted in the prior audit; as a result, it understated the ERAF shift.

Tax Equity Allocation

Revenue and Taxation Code Section 98 and the *Guidelines for County Property Tax Administration Charges and No/Low Property Tax Cities Adjustment*, provided by the County Accounting Standards and Procedures Committee, provide a formula for increasing the amount of property tax allocated to a city that had either no or low property tax revenues.

We noted no findings in this area.

Senate Bill 1096 and Assembly Bill 2115 Reviews

During 2005, we also reviewed the counties' initial implementation of the requirements of SB 1096 (Chapter 211, Statutes of 2004), as amended by AB 2115 (Chapter 610, Statutes of 2004). Although we noted findings, we found that the counties' initial implementation generally complied with those requirements.

We noted that a small number of counties made errors in the ERAF shift amounts for some special districts. These errors resulted from the counties' use of an incorrect shift schedule. We further noted that a small number of counties made errors in the Vehicle License Fee Adjustment amounts because they did not use the latest available revised schedule.

Prior Legislation Points of Interest: *Revenue and Taxation Code* Section 96.81— Consideration of Legislative Action

Revenue and Taxation Code Section 96.81 was added by SB 1096 (Chapter 211, Statutes of 2004). The SCO and Legislative committee staff disagree on the interpretation and application of the section. The SCO legal staff has determined that the section forgives every property tax allocation error in every county where a property tax audit was conducted by the Controller between July 1, 1993, and June 30, 2001, and not solely to Educational Revenue Augmentation Fund (ERAF) errors. Legislative committee staff states "the Legislative intent was to forgive audit findings from the period in question that had determined that local governments had under-allocated the ERAF and owed ERAF money."

It also appears that the Legislative Counsel's Digest review of the section does not support the committee staff's position. The Legislative Counsel's digest does not make any mention of the statute being limited only to audit findings regarding under-allocation errors to ERAF.

Some counties, when responding to draft property tax audit reports, are citing *Revenue and Taxation Code* Section 96.81 as justification for not having to reallocate property tax revenues, although the counties do correct the systems.

Findings of Individual County Audits

Introduction

The findings and recommendations included below are presented as they were stated in the County Property Tax Apportionment and Allocation reports issued by the SCO in calendar year 2005. Unless otherwise indicated, the counties agreed with the findings and recommendations.

The findings and recommendations listed below are solely for the information and use of the California Legislature, the respective counties, the Department of Finance, and the SCO; they are not intended to be and should not be used by anyone other than those specified parties. This restriction is not intended to limit distribution of this report or the respective audit reports, which are a matter of public record.

Butte County (July 1, 2001, through June 30, 2005)

Conclusion

The audit disclosed that the county complied with California statutes for the allocation and apportionment of property tax revenues for the period audited.

Calaveras County (July 1, 1997, through June 30, 2003)

Follow-up on Prior Audit Findings

Findings noted in our prior audit report, dated October 23, 1998, have been satisfactorily resolved by the county, with the exception of a base revenue error that is restated in this audit report.

FINDING 1— Calculation and distribution of ATI

In the prior two audits we noted that an error had been made in the computation of the AB8 Split that transferred revenue from schools to the County General Fund in FY 1979-80. The initial error resulted in an overstatement of revenue to the general fund of \$53,653 with a corresponding understatement of revenue to school districts and the City of Angels Camp.

Requirements for the apportionment and allocation of the annual tax increment (ATI) are found in *Revenue and Taxation Code* Sections 96 through 96.5. The annual increment of property tax, which is the change in assessed value from one year to the next, is allocated to TRAs on the basis of each TRA's share of the incremental growth in assessed valuations. The tax increment is then multiplied by the jurisdiction's ATI apportionment factors for each TRA. These factors were developed in the 1979-80 base year and are adjusted for jurisdictional changes. The tax increment is then added to the tax computed for the prior fiscal year to develop the apportionment for the current fiscal year.

Recommendation

The county has computed corrected revenue amounts for the general fund, school districts, and the City of Angels Camp, and has proposed making adjustments to their base revenue amounts for use in final AB 8 processing for FY 2003-04. If the corrections are implemented as proposed, the base revenue amounts for the General Fund, City of Angels Camp, and all school districts will be correct for the beginning of the FY 2004-05 AB 8 processing cycle.

County's Response

As noted in Calaveras County's response of September 30, 1998 to the State Controller's Office (SCO) Audit Report of the Property Tax Apportionment System for period July 1, 1992, through June 30, 1997 regarding the overstated assistance adjustment that has been ongoing since 1978, it is the County's intent to seek legislation to forgive the original discrepancy and the compounded growth in assessed value. Also noted in this response was the County's lack of available staff to assist in such a comprehensive and manually intensive project at that time. I respectfully requested assistance from the State Controller's Office to complete the task but was denied assistance.

Since the September 30, 1998 response, the County's property tax manager retired and new staff had to be trained. Prior to starting the audit for audit period July 1, 1997 through June 30, 2003, the SCO auditor assisted the recently trained staff so that they were able to satisfactorily recalculate the state assistance adjustment. Adjustments to the base revenue amounts for use in final AB 8 processing for FY 2003-04 were completed. All base revenue amounts for General Fund, City of Angels Camp, and all school districts were correct for the beginning of the FY 2004-05 AB 8 processing cycle.

SCO's Comment

We will review the implementation of the corrections during the next audit period.

**FINDING 2—
Educational Revenue
Augmentation Fund
(ERAF)**

The county failed to properly compute the city and county ERAF per capita computations for all years of this audit period (FY 1997-98 through FY 2002-03). The first two years did not include a growth computation; the third year amounts were increased, but not as much as required; and, in the fourth year, the per capita amounts were deleted.

The ERAF computations for the city and county included a disaster adjustment in FY 1992-93 that was supposed to be reversed for FY 1997-98. The reverse adjustment was not completed, resulting in ERAF amounts for the city and county being understated for all years of this audit period.

The FY 1993-94 ERAF adjustment amounts for all local agencies did not have the required growth computation for FY 2001-02. This resulted in additional understated ERAF contribution amounts for all local agencies for FY 2001-02 and FY 2002-03, as follows.

<u>Fiscal Year</u>	<u>Allocation by County</u>	<u>State Amount per Audit</u>	<u>Audit Adjustment</u>
1997-98	\$ 3,207,758	\$ 3,226,572	\$ 18,814
1998-99	3,346,750	3,368,100	21,350
1999-2000	3,526,573	3,542,982	16,409
2000-01	3,699,038	3,763,048	64,010
2001-02	3,871,726	4,083,117	211,391
2002-03	4,349,476	4,436,873	87,397
Totals	<u>\$ 22,001,321</u>	<u>\$ 22,420,692</u>	<u>\$ 419,371</u>

Requirements for the local agency shift of property tax revenues to the ERAF are generally found in *Revenue and Taxation Code* Sections 97.1 through 97.3. Beginning in FY 1992-93, each local agency was generally required to shift an amount of property tax revenues to the ERAF using formulas detailed in the code. The property tax revenues in the ERAF are subsequently allocated to the public schools using factors supplied by the county superintendent of schools.

For FY 1992-93, the ERAF shift amount for cities was generally determined by adding a per capita amount to a percentage of property tax revenues received by each city. The amount for counties was generally determined by adding a flat amount, adjusted for growth, to a per capita amount. The amount for special districts was generally determined by shifting the lesser of 10% of that district's total annual revenues as shown in the FY 1989-90 edition of the State Controller's *Report on Financial Transactions Concerning Special Districts* or 40% of the FY 1991-92 property tax revenues received, adjusted for growth. Specified special districts were exempted from the shift.

For FY 1993-94, the ERAF shift for cities and counties was generally determined by:

- Reducing the FY 1992-93 ERAF shift by the FY 1992-93 per capita shift;
- Adjusting the result for growth; and
- Adding the result to a flat amount and a per capita amount determined by the Department of Finance, adjusted for growth.

The FY 1993-94 ERAF shift for special districts, other than fire districts, was generally determined by:

- Multiplying the property tax allocation for FY 1992-93, pre-ERAF, by the Special District Augmentation Fund (SDAF) factor for the district effective on June 15, 1993;
- Adjusting this amount by subtracting the FY 1992-93 shift to the ERAF;
- If the above amount is greater than zero, adjusting this amount for FY 1993-94 growth (zero is used for negative amounts); and
- Adding this amount to the FY 1992-93 ERAF shift, adjusting for growth.

For fire districts, the FY 1993-94 ERAF shift was generally determined by:

- Deducting the FY 1992-93 ERAF shift for the district from the FY 1992-93 property tax allocation;
- Multiplying the result by the SDAF factor for the district effective on June 13, 1993 (net current-year bailout equivalent);
- For a district governed by a board of supervisors, deducting the amount received from the SDAF in FY 1992-93 from the net current-year bailout equivalent; or, for an independent district, deducting the amount received from the SDAF and the difference between the net

current-year bailout equivalent and the amount contributed to the SDAF from the net current-year bailout equivalent;

- Adjusting this amount for growth; and
- Adding this amount to the FY 1992-93 ERAF shift, adjusted for growth.

For fiscal years subsequent to FY 1993-94, the amounts determined are adjusted for growth annually to determine the ERAF shift amounts for that year.

Recommendation

The county has computed corrected revenue amounts, for all three issues noted above, for all affected local agencies and has proposed making adjustments to the ERAF contribution amounts for use in the final FY 2003-04 AB 8 process. If the corrections are implemented as proposed, the base ERAF amounts of all local agencies will be correct for the beginning of the FY 2004-05 AB 8 processing cycle.

County's Response

New ERAF computation spreadsheets were completed during the SCO audit to correct revenue amounts affected by the audit findings for all years covered in the audit period. The revised calculations were reviewed and approved by the SCO auditor. Adjustments to ERAF contribution amounts were used in the final FY 2003-04 AB 8 process. All base ERAF amounts for local agencies were correct for the FY 2004-05 AB 8 processing cycle. We are awaiting clarification of *Revenue and Taxation Code* Section 96.81 added by Chapter 211, Statutes of 2004 (Senate Bill 1096) prior to reallocating revised distributions.

Fresno County (July 1, 2000, through June 30, 2003)

Follow-up on Prior Audit Findings

Findings noted in our prior audit report, dated August 11, 2001, have been satisfactorily resolved by the county, with the exception of documentation for supplemental property tax administrative costs and the reversal of the disaster relief amount for the ERAF shift.

FINDING 1— Calculation and distribution of ATI

The gross levy in the AB 8 system was \$916,119 greater than 1% of secured and unsecured assessed values. In addition, the annual tax increment (ATI) for FY 2000-01 did not agree with the 1% net change in secured and unsecured assessed values.

Requirements for the apportionment and allocation of the ATI are found in *Revenue and Taxation Code* Sections 96 through 96.5. The annual increment of property tax, which is the change in assessed value from one year to the next, is allocated to TRAs on the basis of each TRA's share of the incremental growth in assessed valuations. The tax increment is then multiplied by the jurisdiction's ATI factors for each TRA. These factors were developed in the 1979-80 base year and are adjusted for jurisdictional changes. The tax increment is then added to

the tax computed for the prior fiscal year to develop the apportionment for the current fiscal year.

Recommendation

The county must reconcile the AB 8 system gross levy and annual tax increment to 1% of secured and unsecured assessed values. Once reconciled, the county must determine which jurisdiction revenues are overstated and correct those revenues as necessary.

County's Response

We concur with the finding that the AB8 system gross levy did not agree with annual tax increment (ATI) to 1% of secured and unsecured assessed values. We have implemented a process to reconcile the gross levy amount to the ATI on an annual basis. As a part of that process, we have found it necessary to perform extensive analysis of our legacy property tax system to identify the differences. It is anticipated that programming and ongoing corrections will be necessary for some time.

FINDING 2— Jurisdictional changes

The county did not follow the master agreement requirement when making revenue exchanges for city annexation.

The legal requirements for jurisdictional changes are found in *Revenue and Taxation Code* Section 99. A jurisdictional change involves a change in organization or boundaries of local government agencies and school districts. Normally, these are service area or responsibility changes between the local jurisdictions. As part of the jurisdictional change, the local government agencies are required to negotiate any exchange of base year property tax revenue and ATI. After the jurisdictional change, the local agency whose responsibility increased receives additional ATI, and the base property tax revenues are adjusted according to the negotiated agreements.

Recommendation

The county AB 8 system, of which TRA has no base revenue or gross levy, cannot be adjusted in accordance with the current master agreement requirement. Under the current agreement, base revenue and ATI are to be adjusted. However, this is not possible because the existing TRA mechanism carries only fixed factors and annual tax increment.

The county should seek a revision to the master agreement, making it possible to adjust the AB 8 system at the TRA level.

County's Response

Currently, the County has many master agreements (MOUs) in effect with various jurisdictions within Fresno County. When a jurisdictional change occurs, the property tax system is not currently programmed to make the adjustments required. Our process has included manual adjustments made on our internal worksheets for these jurisdictional changes. However, as with most manual processes, it is subject to error. We will pursue system modifications to automate certain processes and insure that the system accurately reflects all existing master agreement terms.

**FINDING 3—
Supplemental
property tax**

The county does not retain supporting documents for the creation of supplemental property tax apportionment factors.

The legal requirements for supplemental roll property tax apportionment and allocation are found in *Revenue and Taxation Code* Sections 75.60 through 75.71 and 100.2. When assessed property value changes due to changes in ownership or completion of new construction, the property owner is charged a supplemental property tax. This process enables the counties to retroactively tax property for the period when changes in ownership or completion of new construction occurred, rather than at the time the secured roll is developed.

Recommendation

The county must maintain supporting documents for the creation of the yearly supplemental apportionment factors.

County's Response

Documentation of all apportionment factors and processes is essential. The County is establishing formal procedures for calculating and documenting all property tax processes and apportionment factors.

**FINDING 4—
Supplemental
property tax-
administrative costs**

As stated in the prior audit, the county did not fully document the administrative cost associated with administering the supplemental property tax revenue. In addition, the county computed the 5% administrative cost reimbursement based on total collections, including cost and penalty.

Revenue and Taxation Code Section 75.60 allows a county to charge an administrative fee for supplemental property tax collections. This fee is not to exceed 5% of the supplemental property taxes collected.

Recommendation

For the county to be eligible for reimbursement, the cost associated in administering the supplemental property tax revenue must be documented. In addition, the county must compute the maximum 5% reimbursement based on collections that exclude cost and penalty amounts.

County's Response

Fresno County has developed specific project codes within the payroll system which will identify detailed work assignments. These project codes correspond to the different types of functions performed, such as supplemental property taxes.

Additionally, we will exclude all penalties from future administrative costs.

**FINDING 5—
Unitary and operating
nonunitary
apportionment**

Redevelopment agencies were excluded from the calculation of excess unitary and operating nonunitary revenue factors when assessed value exceeded 102% of the previous fiscal year.

Requirements for the apportionment and allocation of unitary and operating nonunitary property taxes are found in *Revenue and Taxation Code* Section 100.

Unitary properties are those properties on which the Board of Equalization “may apply the principle of unit valuation in valuing properties of an assessee that are operated as a unit in the primary function of the assessee” (i.e., public utilities and railroads). The *Revenue and Taxation Code* further states, “Operating nonunitary properties are those that the assessee and its regulatory agency consider to be operating as a unit, but the board considers not part of the unit in the primary function of the assessee.”

In FY 1988-89, the Legislature established a separate system for apportioning and allocating unitary and operating nonunitary property taxes. The unitary and operating nonunitary base year was established and formulas were developed to compute the distribution factors for the fiscal years that followed.

Recommendation

Redevelopment agencies must be included in the calculation of excess unitary and operating nonunitary factors when assessed valuation exceeds 102% of the previous fiscal year.

County’s Response

We are in the process of implementing standard procedures that will include redevelopment agencies in the calculation of any excess unitary and operating nonunitary factors when assessed valuation exceeds 102% of the previous fiscal year. In implementing standard procedures, we will be following the applicable sections of the Revenue and Taxation Code and will direct questions to the State Controller’s Office whenever questions arise on the actual application of the code.

**FINDING 6 —
Property tax
administrative costs**

The administrative cost allocation factors did not reconcile to the total combined factors of the AB 8 and unitary and operating nonunitary systems.

Requirements for the reimbursement of county property tax administrative costs are found in *Revenue and Taxation Code* Section 95.3. These administrative costs are incurred by the assessor, the tax collector, the assessment appeals board, and the auditor. The county is allowed, depending on the fiscal year and any corresponding exclusions, to be reimbursed by local agencies and public schools for these administrative costs.

Recommendation

The county must reconcile the total factors for both systems prior to allocating the administrative costs to the various jurisdictions.

County's Response

Concurrent with Findings #1 and #3, the County is establishing formal procedures for reconciling and documenting property tax processes. Further, property tax system modifications will be implemented to facilitate the reconciliation process.

**FINDING 7—
Educational Revenue
Augmentation Fund
(ERAF)**

The annual tax increment for FY 2000-01 in the AB 8 system did not agree with the worksheet that computes the ERAF shift growth factor. In addition, the reversal of the disaster relief amount for FY 1997-98 was computed incorrectly. This error was noted in the prior audit and is restated here.

Requirements for the local agency shift of property tax revenues to the ERAF are generally found in *Revenue and Taxation Code* Sections 97.1 through 97.3. Beginning in FY 1992-93, each local agency was generally required to shift an amount of property tax revenues to the ERAF using formulas detailed in the code. The property tax revenues in the ERAF are subsequently allocated to the public schools using factors supplied by the county superintendent of schools.

For FY 1992-93, the ERAF shift amount for cities was generally determined by adding a per capita amount to a percentage of property tax revenues received by each city. The amount for counties was generally determined by adding a flat amount, adjusted for growth, to a per capita amount. The amount for special districts was generally determined by shifting the lesser of 10% of that district's total annual revenues as shown in the FY 1989-90 edition of the State Controller's *Report on Financial Transactions Concerning Special Districts* or 40% of the FY 1991-92 property tax revenues received, adjusted for growth. Specified special districts were exempted from the shift.

For FY 1993-94, the ERAF shift for cities and counties was generally determined by:

- Reducing the FY 1992-93 ERAF shift by the FY 1992-93 per capita shift;
- Adjusting the result for growth; and
- Adding the result to a flat amount and a per capita amount determined by the Department of Finance, adjusted for growth.

The FY 1993-94 ERAF shift for special districts, other than fire districts, was generally determined by:

- Multiplying the property tax allocation for FY 1992-93, pre-ERAF, by the Special District Augmentation Fund (SDAF) factor for the district effective on June 15, 1993;
- Adjusting this amount by subtracting the FY 1992-93 shift to the ERAF;
- If the above amount is greater than zero, adjusting this amount for FY 1993-94 growth (zero is used for negative amounts); and
- Adding this amount to the FY 1992-93 ERAF shift, adjusting for growth.

For fire districts, the FY 1993-94 ERAF shift was generally determined by:

- Deducting the FY 1992-93 ERAF shift for the district from the FY 1992-93 property tax allocation;
- Multiplying the result by the SDAF factor for the district effective on June 13, 1993 (net current-year bailout equivalent);
- For a district governed by a board of supervisors, deducting the amount received from the SDAF in FY 1992-93 from the net current-year bailout equivalent; or, for an independent district, deducting the amount received from the SDAF and the difference between the net current-year bailout equivalent and the amount contributed to the SDAF from the net current-year bailout equivalent;
- Adjusting this amount for growth; and
- Adding this amount to the FY 1992-93 ERAF shift, adjusted for growth.

For fiscal years subsequent to FY 1993-94, the amounts determined are adjusted for growth annually to determine the ERAF shift amounts for that year.

Recommendation

The county must correct all issues outstanding in the AB 8 system, the unitary and operating nonunitary system, and the error in the ERAF shift, and adjust the ERAF shift accordingly.

Due to the various errors in the property tax system, the SCO could not quantify the correct ERAF shift amount. Therefore, Schedule 1—Summary of Underallocation to the Educational Revenue Augmentation Fund is excluded from this report.

County's Response

Fresno County will retroactively prepare reconciliations and corrections to all outstanding AB 8, unitary and operating nonunitary, and ERAF errors as identified in this report. Appropriate documentation will be prepared and maintained for future audits. Further, the Summary of Underallocation to the Educational Revenue Augmentation Fund will be reviewed and adjusted as necessary.

Humboldt County (July 1, 1998, through June 30, 2003)

Follow-up on Prior Audit Findings

The county satisfactorily resolved the findings noted in our prior audit report, dated November 9, 1999, with the exception of the ERAF disaster reversal, which is restated in this audit.

FINDING 1— Jurisdictional changes

Two annexations were completed during this audit period and, though both of them required the transfer of base year revenue from the county general fund to the cities involved, neither revenue transfer was completed.

The above annexations also required creation of new TRAs and the computation of adjusted TRA increment factors between the county and the cities. The factor adjustments were not computed properly. The new TRAs included factor adjustments for all jurisdictions, rather than simply an adjustment to the county and the cities.

The legal requirements for jurisdictional changes are found in *Revenue and Taxation Code* Section 99. A jurisdictional change involves a change in organization or boundaries of local government agencies and school districts. Normally, these are service area or responsibility changes between the local jurisdictions. As part of the jurisdictional change, the local government agencies are required to negotiate any exchange of base year property tax revenue and annual tax increment. After the jurisdictional change, the local agency whose responsibility increased receives additional annual tax increment, and the base property tax revenues are adjusted according to the negotiated agreements.

Recommendation

The county must correct the base revenue and TRA factors to properly complete the annexations.

FINDING 2— Educational Revenue Augmentation Fund (ERAF)

In our prior audit report, we noted that the county and cities' ERAF disaster adjustment that should have been made in FY 1997-98 was not completed. The adjustment for the cities was completed for FY 1999-2000, and the adjustment for the county was completed for FY 2001-02. However, neither of these adjustments included payment to the ERAF for the prior year amounts that should have been paid.

The county and cities' per capita ERAF adjustments were improperly computed as a reduction of ERAF payments in all years of this audit period. The per capita amounts should be restored and payments computed and made to the ERAF for the years that were incorrectly computed (Schedule 1).

Requirements for the local agency shift of property tax revenues to the ERAF are generally found in *Revenue and Taxation Code* Sections 97.1 through 97.3. Beginning in FY 1992-93, each local agency was generally required to shift an amount of property tax revenues to the ERAF using formulas detailed in the code. The property tax revenues in the ERAF are subsequently allocated to the public schools using factors supplied by the county superintendent of schools.

For FY 1992-93, the ERAF shift amount for cities was generally determined by adding a per capita amount to a percentage of property tax revenues received by each city. The amount for counties was generally determined by adding a flat amount, adjusted for growth, to a per capita amount. The amount for special districts was generally determined by shifting the lesser of 10% of that district's total annual revenues as shown in the FY 1989-90 edition of the State Controller's *Report on Financial Transactions Concerning Special Districts* or 40% of the FY 1991-92 property tax revenues received, adjusted for growth. Specified special districts were exempted from the shift.

For FY 1993-94, the ERAF shift for cities and counties was generally determined by:

- Reducing the FY 1992-93 ERAF shift by the FY 1992-93 per capita shift;
- Adjusting the result for growth; and
- Adding the result to a flat amount and a per capita amount determined by the Department of Finance, adjusted for growth.

The FY 1993-94 ERAF shift for special districts, other than fire districts, was generally determined by:

- Multiplying the property tax allocation for FY 1992-93, pre-ERAF, by the Special District Augmentation Fund (SDAF) factor for the district effective on June 15, 1993;
- Adjusting this amount by subtracting the FY 1992-93 shift to the ERAF;
- If the above amount is greater than zero, adjusting this amount for FY 1993-94 growth (zero is used for negative amounts); and
- Adding this amount to the FY 1992-93 ERAF shift, adjusting for growth.

For fire districts, the FY 1993-94 ERAF shift was generally determined by:

- Deducting the FY 1992-93 ERAF shift for the district from the FY 1992-93 property tax allocation;
- Multiplying the result by the SDAF factor for the district effective on June 13, 1993 (net current-year bailout equivalent);
- For a district governed by a board of supervisors, deducting the amount received from the SDAF in FY 1992-93 from the net current-year bailout equivalent; or, for an independent district, deducting the amount received from the SDAF and the difference between the net current-year bailout equivalent and the amount contributed to the SDAF from the net current-year bailout equivalent;
- Adjusting this amount for growth; and
- Adding this amount to the FY 1992-93 ERAF shift, adjusted for growth.

For fiscal years subsequent to FY 1993-94, the amounts determined are adjusted for growth annually to determine the ERAF shift amounts for that year.

Recommendation

The county must complete the ERAF corrections noted above and make provisions for reimbursing the ERAF for prior-year errors.

Lassen County (July 1, 1998, through June 30, 2004)

Follow-up on Prior Audit Findings	Findings noted in our prior audit report, issued October 22, 1999, have been satisfactorily resolved by the county.
Conclusion	Our audit disclosed that the county complied with California statutes for the allocation and apportionment of property tax revenues for the period audited.

Marin County (July 1, 2001, through June 30, 2004)

Follow-up on Prior Audit Findings	Our prior audit report, issued May 24, 2002, had no findings related to the apportionment and allocation of property tax revenues by the county.
Conclusion	Our audit disclosed that the county complied with California statutes for the allocation and apportionment of property tax revenues for the period audited.

Modoc County (July 1, 1999, through June 30, 2004)

Follow-up on Prior Audit Findings	Findings noted in our prior audit report, issued April 28, 2000, have been satisfactorily resolved by the county.
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FINDING 1— Calculation and distribution of ATI	The county excluded the state-assessed local utility roll from the increment calculations for fiscal year (FY) 2002-03 and FY 2003-04. This mistake understated increment and gross revenue amounts to most taxing entities in the county. This error was generally offset by a corresponding overstatement of revenue in the unitary property tax system.
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Requirements for the apportionment and allocation of the annual tax increment (ATI) are found in *Revenue and Taxation Code* Sections 96 through 96.5. The annual increment of property tax, which is the change in assessed value from one year to the next, is allocated to tax rate areas (TRAs) on the basis of each TRA's share of the incremental growth in assessed valuations. The tax increment is then multiplied by the jurisdiction's ATI apportionment factors for each TRA. These factors were developed in the 1979-80 base year and are adjusted for jurisdictional changes. The tax increment is then added to the tax computed for the prior fiscal year to develop the apportionment for the current fiscal year.

Recommendation

The county computed corrected increment and revenue amounts for all affected taxing entities through the end of FY 2003-04 during the audit. If the corrected revenue amounts are used to begin the FY 2004-05 tax process, no further corrections will be necessary.

County's Response

As stated in the draft, we have computed corrected increment and revenue amounts for all affected entities through the end of FY2003/04 and our spreadsheets are corrected beginning FY2004/05 tax year.

**FINDING 2—
Supplemental
property tax—
administrative costs**

The supplemental tax 5% administrative fee was improperly computed on total revenues received prior to removing penalties and costs.

Revenue and Taxation Code Section 75.60 allows a county to charge an administrative fee for supplemental property tax collections. This fee is not to exceed 5% of the supplemental property taxes collected.

Recommendation

The county must ensure that future calculations of supplemental administrative costs are made on total collections after the removal of penalties and costs that are paid to the county general fund. Since the amount collected by this miscalculation was deemed immaterial, no prior revenue adjustments are requested.

County's Response

We have corrected our computed calculation of supplemental administrative fee on our current spreadsheets so this should be correct in FY2004/05 and future years.

**FINDING 3—
Unitary and operating
nonunitary
apportionment**

The unitary and operating nonunitary property tax computations were improperly computed for FY 2001-02, FY 2002-03, and FY 2003-04. The first error resulted in understated revenue for many taxing entities due to the incorrect computation of decreased total revenue. The second and third errors were the result of overstated assessed value, corresponding to the understatement of ATI value noted earlier in this report. These errors were offset by the corresponding errors in the ATI calculations for these years.

Requirements for the apportionment and allocation of unitary and operating nonunitary property taxes are found in *Revenue and Taxation Code* Section 100.

Unitary properties are those properties on which the Board of Equalization "may apply the principle of unit valuation in valuing properties of an assessee that are operated as a unit in the primary function of the assessee" (i.e., public utilities and railroads). The *Revenue and Taxation Code* further states, "Operating nonunitary properties are those that the assessee and its regulatory agency consider to be operating as a unit, but the board considers not part of the unit in the primary function of the assessee."

In FY 1988-89, the Legislature established a separate system for apportioning and allocating the unitary and operating nonunitary property taxes. The unitary and operating nonunitary base year was established and formulas were developed to compute the distribution factors for the fiscal years that followed.

Recommendation

The county computed corrected unitary revenue amounts for all affected taxing entities through the end of FY 2003-04 during the audit. If the corrected revenue amounts are used to begin the FY 2004-05 tax process, no further corrections will be necessary.

County's Response

We have computed corrected unitary revenue amounts for the FY2004/05 tax process and will continue to do so in the future.

**FINDING 4—
Property tax
administrative costs**

The county made some minor errors in the computation of countywide administrative costs charged in FY 2002-03 and FY 2003-04. Some allowed costs were not properly recorded, some costs were overstated and others understated, and some offsetting revenues were understated.

Requirements for the reimbursement of county property tax administrative costs are found in *Revenue and Taxation Code* Section 95.3. County property tax administrative costs are incurred by the assessor, the tax collector, the assessment appeals board, and the auditor. The county is allowed, depending on the fiscal year and any corresponding exclusions, to be reimbursed by local agencies and public schools for these administrative costs.

Recommendation

The county must ensure that administrative cost computations in future years are properly recorded and that all appropriate revenues and fees are included to offset costs as required. Since the net impact of these errors was deemed immaterial, no prior year revenue adjustments are requested.

County's Response

We have computed corrected administrative cost computations for use in FY2004/05 and future calculations.

Monterey County (July 1, 2000, through June 30, 2003)

**Follow-up on Prior
Audit Findings**

Findings noted in our prior audit report, dated March 30, 2001, have been satisfactorily resolved by the county, with the exception of the ERAF. The county needs to complete the appropriate corrections to the ERAF.

**FINDING 1—
Supplemental
property tax**

We noted an error in the apportionment of supplemental taxes for FY 2001-02 and FY 2002-03. The county revised its apportionment factors but did not implement the revised factors when computing the supplemental apportionments.

The legal requirements for supplemental roll property tax apportionment and allocation are found in *Revenue and Taxation Code* Sections 75.60 through 75.71 and 100.2. When a change in assessed property value is caused by changes in ownership or completion of new construction, the

property owner is charged a supplemental property tax. This process enables the counties to retroactively tax property for the period when changes in ownership or completion of new construction occurred, rather than at the time the secured roll is developed.

Recommendation

The county should adjust the FY 2001-02 and FY 2002-03 supplemental apportionments using the correct revised factors.

County's Response

Monterey County has corrected the factors for the two fiscal years involved and made the adjustments to the supplemental apportionments.

FINDING 2— Redevelopment agencies

The county made the following errors, resulting in overstated increment contributions by two separate redevelopment areas.

When the current-year value decreased below the base-year value within the Marina Airport RDA, the county charged the RDA for the revenue decrease (decrement) and gave it to the applicable districts.

The pass-through computations exceeded the increment available for one district within the King City RDA. The county charged the excess amount to the RDA and gave it to the district.

Requirements for the apportionment and allocation of property tax to RDAs are found in *Revenue and Taxation Code* Sections 96.4 and 96.5. California Community Redevelopment Law generally entitles a community RDA to all of the property tax revenues that are realized from growth in values since the redevelopment project's inception.

Recommendation

The county methodology should be corrected so that when a decrement occurs, RDAs do not lose additional revenue to the districts. Also, the pass-through amounts should be capped at the amount of increment available for the King City RDA pursuant to the originating agreement between the RDA, the county, and the Flood Control Water Conservation District.

County's Response

Monterey County has changed its methodology to prevent future occurrences.

FINDING 3— Unitary and operating nonunitary apportionment

The county did not properly compute growth for the unitary and operating nonunitary property tax system in FY 2002-03 when the assessed valuation exceeded 2% over the preceding year. The county incorrectly used the current-year AB 8 factors instead of the prior-year AB 8 factors.

Requirements for the apportionment and allocation of unitary and operating nonunitary property taxes are found in *Revenue and Taxation Code* Section 100.

Unitary properties are those properties on which the Board of Equalization “may apply the principle of unit valuation in valuing properties of an assessee that are operated as a unit in the primary function of the assessee” (i.e., public utilities and railroads). The *Revenue and Taxation Code* further states, “Operating nonunitary properties are those that the assessee and its regulatory agency consider to be operating as a unit, but the board considers not part of the unit in the primary function of the assessee.”

In FY 1988-89, the Legislature established a separate system for apportioning and allocating unitary and operating nonunitary property taxes. The unitary and operating nonunitary base year was established, and formulas were developed to compute the distribution factors for the fiscal years that followed.

Recommendation

The county should adjust the FY 2002-03 unitary and operating nonunitary growth computation using the prior-year AB 8 factors instead of the current-year AB 8 factors.

County’s Response

Monterey County has recomputed the unitary factors using the prior year AB 8 factors and made the adjustments to the agencies.

FINDING 4— Educational Revenue Augmentation Fund (ERAF)

The prior audit report noted that the ERAF shift was not computed properly in FY 1997-98. The ERAF shifts from the county, one city, and several special districts were understated for the year while six cities and a few special districts were overstated.

Requirements for the local agency shift of property tax revenues to the ERAF are generally found in *Revenue and Taxation Code* Sections 97.1 through 97.3. Beginning in FY 1992-93, each local agency was generally required to shift an amount of property tax revenues to the ERAF using formulas detailed in the code. The property tax revenues in the ERAF are subsequently allocated to the public schools using factors supplied by the county superintendent of schools.

For FY 1992-93, the ERAF shift amount for cities was generally determined by adding a per capita amount to a percentage of property tax revenues received by each city. The amount for counties was generally determined by adding a flat amount, adjusted for growth, to a per capita amount. The amount for special districts was generally determined by shifting the lesser of 10% of that district’s total annual revenues as shown in the FY 1989-90 edition of the State Controller’s *Report on Financial Transactions Concerning Special Districts* or 40% of the FY 1991-92 property tax revenues received, adjusted for growth. Specified special districts were exempted from the shift.

For FY 1993-94, the ERAF shift for cities and counties was generally determined by:

- Reducing the FY 1992-93 ERAF shift by the FY 1992-93 per capita shift;
- Adjusting the result for growth; and
- Adding the result to a flat amount and a per capita amount determined by the Department of Finance, adjusted for growth.

The FY 1993-94 ERAF shift for special districts, other than fire districts, was generally determined by:

- Multiplying the property tax allocation for FY 1992-93, pre-ERAF, by the Special District Augmentation Fund (SDAF) factor for the district effective on June 15, 1993;
- Adjusting this amount by subtracting the FY 1992-93 shift to the ERAF;
- If the above amount is greater than zero, adjusting this amount for FY 1993-94 growth (zero is used for negative amounts); and
- Adding this amount to the FY 1992-93 ERAF shift, adjusting for growth.

For fire districts, the FY 1993-94 ERAF shift was generally determined by:

- Deducting the FY 1992-93 ERAF shift for the district from the FY 1992-93 property tax allocation;
- Multiplying the result by the SDAF factor for the district effective on June 13, 1993 (net current-year bailout equivalent);
- For a district governed by a board of supervisors, deducting the amount received from the SDAF in FY 1992-93 from the net current-year bailout equivalent; or, for an independent district, deducting the amount received from the SDAF and the difference between the net current-year bailout equivalent and the amount contributed to the SDAF from the net current-year bailout equivalent;
- Adjusting this amount for growth; and
- Adding this amount to the FY 1992-93 ERAF shift, adjusted for growth.

For fiscal years subsequent to FY 1993-94, the amounts determined are adjusted for growth annually to determine the ERAF shift amounts for that year.

Recommendation

The county needs to complete the appropriate corrections to the ERAF.

County's Response

Monterey County has completed making the corrections to ERAF.

Napa County (July 1, 1996, through June 30, 2003)

Follow-up on Prior Audit Findings

The county satisfactorily resolved the findings noted in our prior audit, dated September 11, 1997, with the exception of findings related to the ERAF shift and the unitary and operating nonunitary base computation. These findings are restated in this report.

FINDING 1— Unitary and operating nonunitary apportionment

As noted in our prior audit report, the methodology used by the county to compute the base unitary and operating nonunitary amounts could not be determined. Working papers, apportionment amounts, or procedures used to develop the unitary and operating nonunitary base year apportionments could not be provided by the county.

We reconstructed a sample of jurisdictions' unitary and operating nonunitary computations for comparison to the first year (FY 1992-93) of county unitary and operating nonunitary records available. The SCO-computed amounts did not reconcile with the county computations.

Requirements for the apportionment and allocation of unitary and operating nonunitary property taxes are found in *Revenue and Taxation Code* Section 100.

Unitary properties are those properties on which the Board of Equalization "may apply the principle of unit valuation in valuing properties of an assessee that are operated as a unit in the primary function of the assessee" (i.e., public utilities and railroads). The *Revenue and Taxation Code* further states, "Operating nonunitary properties are those that the assessee and its regulatory agency consider to be operating as a unit, but the board considers not part of the unit in the primary function of the assessee."

In FY 1988-89, the Legislature established a separate system for apportioning and allocating the unitary and operating nonunitary property taxes. The unitary and operating nonunitary base year was established and formulas were developed to compute the distribution factors for the fiscal years that followed.

Recommendation

The county must recompute the unitary and nonunitary base revenue amounts for all jurisdictions and update the amounts for each year, as specified by statute, to achieve a correct file for the current fiscal year.

FINDING 2— Educational Revenue Augmentation Fund (ERAF)

As noted in our prior audit report, the county made several errors in the computation of the ERAF shift amounts for the county structural fire districts, City of Napa, library, and special districts in FY 1992-93 through FY 1995-96.

The county computed the FY 1992-93 City of Napa ERAF contribution incorrectly. The contribution was computed using 9% of revenue. The revenue amount used by the county included a redevelopment increment, resulting in the overstatement of the 9% city computation.

The county computed the structural fire and library ERAF contributions for FY 1993-94 improperly. The fire district computation inappropriately included a Special District Augmentation Fund loss adjustment and the county library amount appears to have been carried forward incorrectly.

The county properly computed the FY 1993-94 special district ERAF contributions but failed to compute growth for the year.

During the current audit period, the county computed growth incorrectly in FY 1997-98 through FY 2002-03, as follows.

<u>Fiscal Year</u>	<u>Allocation by County</u>	<u>State Amount per Audit</u>	<u>Audit Adjustment</u>
1992-93	\$ 2,813,321	\$ 2,783,393	\$ (29,928)
1993-94	10,914,890	10,885,731	(29,159)
1994-95	11,320,104	11,290,171	(29,933)
1995-96	11,669,285	11,638,056	(31,229)
1996-97	12,055,566	12,023,581	(31,985)
1997-98	12,589,242	12,572,674	(16,568)
1998-99	13,316,198	13,345,297	29,099
1999-2000	14,408,634	14,545,329	136,695
2000-01	15,715,289	16,000,252	284,963
2001-02	17,483,046	18,031,250	548,204
2002-03	18,971,922	19,709,716	737,794
Total	<u>\$ 141,257,497</u>	<u>\$ 142,825,450</u>	<u>\$ 1,567,953</u>

Requirements for the local agency shift of property tax revenues to the ERAF are generally found in *Revenue and Taxation Code* Sections 97.1 through 97.3. Beginning in FY 1992-93, each local agency was generally required to shift an amount of property tax revenues to the ERAF using formulas detailed in the code. The property tax revenues in the ERAF are subsequently allocated to the public schools using factors supplied by the county superintendent of schools.

For FY 1992-93, the ERAF shift amount for cities was generally determined by adding a per capita amount to a percentage of property tax revenues received by each city. The amount for counties was generally determined by adding a flat amount, adjusted for growth, to a per capita amount. The amount for special districts was generally determined by shifting the lesser of 10% of that district's total annual revenues as shown in the FY 1989-90 edition of the State Controller's *Report on Financial Transactions Concerning Special Districts* or 40% of the FY 1991-92 property tax revenues received, adjusted for growth. Specified special districts were exempted from the shift.

For FY 1993-94, the ERAF shift for cities and counties was generally determined by:

- Reducing the FY 1992-93 ERAF shift by the FY 1992-93 per capita shift;
- Adjusting the result for growth; and
- Adding the result to a flat amount and a per capita amount determined by the Department of Finance, adjusted for growth.

The FY 1993-94 ERAF shift for special districts, other than fire districts, was generally determined by:

- Multiplying the property tax allocation for FY 1992-93, pre-ERAF, by the Special District Augmentation Fund (SDAF) factor for the district effective on June 15, 1993;
- Adjusting this amount by subtracting the FY 1992-93 shift to the ERAF;
- If the above amount is greater than zero, adjusting this amount for FY 1993-94 growth (zero is used for negative amounts); and
- Adding this amount to the FY 1992-93 ERAF shift, adjusting for growth.

For fire districts, the FY 1993-94 ERAF shift was generally determined by:

- Deducting the FY 1992-93 ERAF shift for the district from the FY 1992-93 property tax allocation;
- Multiplying the result by the SDAF factor for the district effective on June 13, 1993 (net current-year bailout equivalent);
- For a district governed by a board of supervisors, deducting the amount received from the SDAF in FY 1992-93 from the net current-year bailout equivalent; or, for an independent district, deducting the amount received from the SDAF and the difference between the net current-year bailout equivalent and the amount contributed to the SDAF from the net current-year bailout equivalent;
- Adjusting this amount for growth; and
- Adding this amount to the FY 1992-93 ERAF shift, adjusted for growth.

For fiscal years subsequent to FY 1993-94, the amounts determined are adjusted for growth annually to determine the ERAF shift amounts for that year.

Recommendation

During the current audit, we assisted the county with the correction of the current and prior ERAF findings. As a result of the ERAF findings, the county owes a net amount of \$1,567,953 to the ERAF for FY 1992-93 through FY 2002-03. Due to SB 1096, findings requiring repayment from July 1, 1993, through June 30, 2001, have been forgiven. Therefore, the amount the county owed to the ERAF is limited to FY 1992-93, FY 2001-02, and FY 2002-03. The net amount the county owed in these fiscal years is \$1,256,069.

We issued a draft report on July 20, 2005. We did not receive a response from the county.

These items will be reviewed during the next audit to confirm that the corrections were properly implemented.

Orange County (July 1, 1999, through June 30, 2002)

Follow-up on Prior Audit Findings

Findings noted in our prior audit report, issued January 31, 2002, have been satisfactorily resolved by the county.

FINDING 1— Supplemental property tax— administrative costs

The county charged the 5% supplemental administrative fee to all entities within the basic levy district, except for the redevelopment projects, resulting in a \$232,301 overcharge to the ERAF, as follows.

Fiscal Year	Charge by County	State Amount per Audit	Audit Overcharge Adjustment
1999-2000	\$ 777,269	\$ 707,582	\$ 69,687
2000-01	831,563	754,769	76,794
2001-02	898,758	812,938	85,820
Totals	<u>\$ 2,507,590</u>	<u>\$ 2,275,289</u>	<u>\$ 232,301</u>

The county computed the 5% supplemental administrative fee on penalties and costs, then charged all basic levy districts, except for redevelopment projects.

Revenue and Taxation Code Section 75.60 allows a county to charge an administrative fee for supplemental property tax collections. This fee is not to exceed 5% of the supplemental property taxes collected.

Recommendation

The county should adopt procedures to ensure that basic levy districts, including ERAF, are not charged for penalties and costs or for the RDA share of the supplemental administrative fee. The county should make appropriate corrections to all entities and repay the ERAF \$232,301 for its share of the lost revenues in FY 1999-2000 through FY 2001-02.

County's Response

Concur. The County has changed its procedures to ensure that basic levy districts, including ERAF, are not charged for penalties and costs or the RDA share of the supplemental administrative fee. The ERAF has been repaid for its share of the lost revenues in FYs 1999/00 through 2001/02.

FINDING 2— Redevelopment agencies

The county was unable to substantiate the base year values used to compute the increment for the West Anaheim Commercial Corridor redevelopment project.

The county did not transfer all of the parcels located within the West Anaheim Commercial Corridor redevelopment project to the project TRAs.

Requirements for the apportionment and allocation of property tax to RDAs are found in *Revenue and Taxation Code* Sections 96.4 and 96.5. California Community Redevelopment Law generally entitles a community redevelopment agency to all of the property tax revenues that are realized from growth in values since the redevelopment project's inception.

Recommendation

The county should develop procedures and install appropriate safeguards to ensure that all parcels within redevelopment project boundaries are properly identified and recorded in the proper TRAs.

The county should adopt procedures verifying that the appropriate values are located within redevelopment projects, so that RDA increment is properly computed.

County's Response

Concur. The County corrected the errors and instituted steps to prevent their occurrence in the future. Corrections were made to the roll in January 2003, procedures were updated and reviewed with staff, and an additional procedure was implemented to include an additional senior level review.

Placer County (July 1, 2001, through June 30, 2004)**Follow-up on Prior Audit Findings**

Findings noted in our prior audit report, dated May 24, 2002, have been satisfactorily resolved by the county.

Conclusion

Our audit disclosed that the county complied with California statutes for the allocation and apportionment of property tax revenues for the period audited.

Plumas County (July 1, 1999, through June 30, 2005)**Follow-up on Prior Audit Findings**

The county satisfactorily resolved findings noted in our prior audit report, issued October 20, 1999.

Conclusion

Our audit disclosed that the county complied with California statutes for the allocation and apportionment of property tax revenues for the period audited.

San Benito County (July 1, 1997, through June 30, 2002)**Follow-up on Prior Audit Findings**

Findings noted in our prior audit report, dated December 11, 1998, have been satisfactorily resolved by the county, with the exception of the ERAF shift.

**FINDING 1—
Jurisdictional changes**

The county does not transfer unsecured values from existing tax rate areas (TRAs) to resulting TRAs.

The county does not adjust the prior-year assessed valuation for the homeowner's exemption when transferring assessed valuations from existing TRAs to resulting TRAs.

The revenue exchange calculations did not agree with the jurisdiction agreement.

The legal requirements for jurisdictional changes are found in *Revenue and Taxation Code* Section 99. A jurisdictional change involves a change in organization or boundaries of local government agencies and school districts. Normally, these are service area or responsibility changes between the local jurisdictions. As part of the jurisdictional change, the local government agencies are required to negotiate any exchange of base year property tax revenue and annual tax increment. After the jurisdictional change, the local agency whose responsibility increased receives additional annual tax increment, and the base property tax revenues are adjusted according to the negotiated agreements.

Recommendation

The county must transfer all assessed values for properties identified in jurisdictional changes and follow the stated agreement between entities.

County's Response

We agree with the recommendation and are working with the Assessor's office to get the unsecured values necessary to complete the jurisdictional changes. Adjustments for Homeowner's exemption in prior-year assessed valuation when transferring assessed valuations have also been implemented.

FINDING 2— Supplemental property tax

The apportionment system for supplemental revenues included Redevelopment Agencies (RDA). In addition, prior supplemental revenues were apportioned using current year supplemental revenue factors.

The legal requirements for supplemental roll property tax apportionment and allocation are found in *Revenue and Taxation Code* Sections 75.60 through 75.71 and 100.2. When there is a change in assessed property value due to changes in ownership or completion of new construction, the property owner is charged a supplemental property tax. This process enables the counties to retroactively tax property for the period when changes in ownership or completion of new construction occurred, rather than at the time the secured roll is developed.

Recommendation

The RDA supplemental revenues identified within the TRAs of the RDA must be allocated directly to the RDA.

Prior supplemental revenues must use prior supplemental apportionment factors.

County's Response

We agree with this recommendation and have implemented.

**FINDING 3—
Supplemental
property tax—
administrative costs**

The county general fund was reimbursed 5% of supplemental revenue without documenting the actual supplemental administrative costs.

Revenue and Taxation Code Section 75.60 allows a county to charge an administrative fee for supplemental property tax collections. This fee is not to exceed 5% of the supplemental property taxes collected.

Recommendation

The county must document the actual costs of administering the supplemental process to be eligible for reimbursement.

County's Response

We agree with recommendation and have documented the administrative costs.

**FINDING 4—
Unitary and operating
nonunitary
apportionment**

The apportionment factors in fiscal year (FY) 1998-99 were adjusted when revenue exceeded 102%, but no adjustment was made in FY 1999-2000, FY 2000-01, and FY 2001-02.

Requirements for the apportionment and allocation of unitary and operating nonunitary property taxes are found in *Revenue and Taxation Code* Section 100.

Unitary properties are those properties on which the Board of Equalization "may apply the principle of unit valuation in valuing properties of an assessee that are operated as a unit in the primary function of the assessee" (i.e., public utilities and railroads). The *Revenue and Taxation Code* further states, "Operating nonunitary properties are those that the assessee and its regulatory agency consider to be operating as a unit, but the board considers not part of the unit in the primary function of the assessee."

In FY 1988-89, the Legislature established a separate system for apportioning and allocating the unitary and operating nonunitary property taxes. The unitary and operating nonunitary base year was established and formulas were developed to compute the distribution factors for the fiscal years that followed.

Recommendation

The apportionment factors for unitary and operating nonunitary property taxes in subsequent fiscal years should be consistent with the adjusted factor from the previous fiscal year unless those fiscal year revenues also exceed 102%.

County's Response

We agree with this recommendation and have followed the correct procedures in the fiscal years following FY2001-02.

**FINDING 5—
Property tax
administrative costs**

The property tax administrative cost reimbursement allocation in FY 2001-02 was computed using the costs from FY 1999-2000. The county did not compile the costs in FY 2000-01.

Requirements for the reimbursement of county property tax administrative costs are found in *Revenue and Taxation Code* Section 95.3. County property tax administrative costs are incurred by the assessor, the tax collector, the assessment appeals board, and the auditor. The county is allowed, depending on the fiscal year and any corresponding exclusions, to be reimbursed by local agencies and public schools for these administrative costs.

Recommendation

The prior fiscal year costs must be supported and used in computing the property tax administrative cost reimbursement allocation for the subsequent fiscal year.

County's Response

We agree with this recommendation and have so implemented. Supporting documentation for administrative costs for FY 2002-03 and FY 2003-04 are on file.

**FINDING 6—
Educational Revenue
Augmentation Fund
(ERAF)**

As stated in the prior SCO audit, the disaster relief amounts were not reversed in FY 1997-98. The following errors were identified (see schedule below):

- The disaster relief amounts were not reversed in FY 1997-98.
- The ERAF shift growth factor calculation included RDA revenues.
- The ERAF shift growth factor was incorrectly computed by reversing the numerator and denominator.
- The prior ERAF shift understatement, as noted in the prior SCO audit, was not fully corrected.

<u>Fiscal Year</u>	<u>Allocation by County</u>	<u>State Amount per Audit</u>	<u>Audit Adjustment</u>
1993-94	\$ 2,476,165	\$ 2,477,344	\$ 1,179
1994-95	2,514,587	2,601,028	86,441
1995-96	2,549,687	2,767,676	217,990
1996-97	2,535,866	2,936,496	400,629
1997-98	2,551,816	3,110,515	558,699
1998-99	2,756,592	3,402,813	646,221
1999-2000	3,072,696	3,860,931	788,235
2000-01	3,416,759	4,317,348	900,589
2001-02	3,769,067	4,780,786	1,011,719
Totals	<u>\$ 25,643,235</u>	<u>\$ 30,254,937</u>	<u>\$ 4,611,702</u>

Requirements for the local agency shift of property tax revenues to the ERAF are generally found in *Revenue and Taxation Code* Sections 97.1 through 97.3. Beginning in FY 1992-93, each local agency was generally required to shift an amount of property tax revenues to the ERAF using formulas detailed in the code. The property tax revenues in the ERAF are subsequently allocated to the public schools using factors supplied by the county superintendent of schools.

For FY 1992-93, the ERAF shift amount for cities was generally determined by adding a per capita amount to a percentage of property tax revenues received by each city. The amount for counties was generally determined by adding a flat amount, adjusted for growth, to a per capita amount. The amount for special districts was generally determined by shifting the lesser of 10% of that district's total annual revenues as shown in the FY 1989-90 edition of the State Controller's *Report on Financial Transactions Concerning Special Districts* or 40% of the FY 1991-92 property tax revenues received, adjusted for growth. Specified special districts were exempted from the shift.

For FY 1993-94, the ERAF shift for cities and counties was generally determined by:

- Reducing the FY 1992-93 ERAF shift by the FY 1992-93 per capita shift;
- Adjusting the result for growth; and
- Adding the result to a flat amount and a per capita amount determined by the Department of Finance, adjusted for growth.

The FY 1993-94 ERAF shift for special districts, other than fire districts, was generally determined by:

- Multiplying the property tax allocation for FY 1992-93, pre-ERAF, by the Special District Augmentation Fund (SDAF) factor for the district effective on June 15, 1993;
- Adjusting this amount by subtracting the FY 1992-93 shift to the ERAF;
- If the above amount is greater than zero, adjusting this amount for FY 1993-94 growth (zero is used for negative amounts); and
- Adding this amount to the FY 1992-93 ERAF shift, adjusting for growth.

For fire districts, the FY 1993-94 ERAF shift was generally determined by:

- Deducting the FY 1992-93 ERAF shift for the district from the FY 1992-93 property tax allocation;
- Multiplying the result by the SDAF factor for the district effective on June 13, 1993 (net current-year bailout equivalent);
- For a district governed by a board of supervisors, deducting the amount received from the SDAF in FY 1992-93 from the net current-year bailout equivalent; or, for an independent district, deducting the amount received from the SDAF and the difference between the net current-year bailout equivalent and the amount contributed to the SDAF from the net current-year bailout equivalent;
- Adjusting this amount for growth; and
- Adding this amount to the FY 1992-93 ERAF shift, adjusted for growth.

For fiscal years subsequent to FY 1993-94, the amounts determined are adjusted for growth annually to determine the ERAF shift amounts for that year.

The total underallocation to the ERAF is \$4,611,702. However, *Revenue and Taxation Code* Sections 96.1(b) and 96.1(c)(3) limit the adjustments to the following amounts:

- For the period of July 1, 1993, through June 30, 2002, the county underallocated \$3,929,689 under *Revenue and Taxation Code* Section 96.1(b).
- For the period of July 1, 1997, through June 30, 2002, the county underallocated \$489,790 under *Revenue and Taxation Code* Section 96.1(c)(3). This section code limits the maximum adjustment to the ERAF to 1% of the current year's original secured tax levy and forgave any errors prior to July 1, 1997. Information provided by the county indicates that the current year's secured property tax levy was \$43,928,408. Thus the maximum payment to the ERAF for this finding is \$439,284.

Recommendation

The county should correct all errors in the ERAF shift calculation and carry forward the correct amount in the AB 8 system beginning with FY 2002-03.

The county should reimburse the ERAF for amounts specified under *Revenue and Taxation Code* Sections 96.1(b) and 96.1(c)(3).

County's Response

We disagree with the State Controller's Office interpretation of R&T Code 96.1(b) for the period of July 1, 1993 through June 30, 2002 in the under allocation of \$3,929,689 and have so corresponded in prior letters to Mr. Richard Chivaro, Esq., Chief Legal Counsel, State Controller's Office.

SCO's Comment

The SCO legal staff has opined that the county fails to satisfy *Revenue and Taxation Code* Section 96.1(b). Therefore, the finding remains as stated.

Additional Comment— Request for assistance from the SCO

In its response, the county had the following additional comment.

County's Response

We would like to request at your earliest convenience a site assistance visit for a follow-up review and for technical assistance by Mr. Moses Laurel of your audit staff. We believe that a short visit of a day or less would be beneficial in preventing future audit exceptions.

SCO's Comment

We accept the opportunity to provide the county technical assistance and will arrange for a site assistance visit in the immediate future.

San Bernardino County (July 1, 2000, through June 30, 2004)

Follow-up on Prior Audit Findings

Findings noted in our prior audit, issued October 31, 2001, have been satisfactorily resolved, with the exception of the county failing to correct a prior audit finding in which it recomputed the annual tax increment apportionment factors in all tax rate areas each year, causing the factors to be inconsistent from year to year.

FINDING— Calculation and distribution of ATI

As noted in the prior audit, the county recomputed the annual tax increment (ATI) factors for all jurisdictions in all tax rate areas (TRAs) each year, causing the factors to be inconsistent from year to year. *Revenue and Taxation Code* Section 96.5 states that the TRA apportionment factors should not change, except as needed for jurisdictional changes. The county's methodology of adjusting the ATI factors annually results in different increment computations for most jurisdictions. As the ERAF is computed at the TRA level and the factors are adjusted each year, we cannot determine the accuracy of the ERAF increment computation.

Requirements for the apportionment and allocation of the ATI are found in *Revenue and Taxation Code* Sections 96 through 96.5. The annual increment of property tax, which is the change in assessed value from one year to the next, is allocated to TRAs on the basis of each TRA's share of the incremental growth in assessed valuations. The tax increment is then multiplied by the jurisdiction's ATI apportionment factors for each TRA. These factors were developed in the 1979-80 base year and are adjusted for jurisdictional changes. The tax increment is then added to the tax computed for the prior fiscal year to develop the apportionment for the current fiscal year.

Recommendation

The county should adjust only the ATI factors for jurisdictions in TRAs as necessary to accommodate jurisdictional changes.

County's Response

We agree with the State Controller's Office (SCO) interpretation of Revenue & Taxation code 96.5. This was a finding in the prior audit. Although this condition had not been corrected at the time of this audit, we had, prior to the audit, submitted a formal request to our county's Information Services Department to correct this condition. Currently, programming changes are complete that will accommodate this recommendation and the frozen factors will be used for the 2005/2006 roll year.

San Luis Obispo County (July 1, 2001, through June 30, 2004)

Follow-up on Prior Audit Findings

Our prior audit report, issued May 12, 2002, had no findings related to the apportionment and allocation of property tax revenues by the county.

Conclusion

Our audit disclosed that the county complied with California statutes for the allocation and apportionment of property tax revenues for the period audited.

Santa Clara County (July 1, 1995, through June 30, 2003)

Follow-up on Prior Audit Findings

Findings noted in the prior audit, dated April 29, 1997, have been satisfactorily resolved by the county, with one exception: the county should remove the unitary and operating nonunitary assessed values from the AB 8 system and proportionately allocate the amount to the participating jurisdictions prior to computing these jurisdictions' base factors, in the unitary and operating nonunitary apportionment system.

FINDING— Unitary and operating nonunitary apportionment

As stated in our prior SCO audit, the county did not remove the assessed values of unitary and operating nonunitary property from the pre-1989 RDA base amount in the AB 8 apportionment system. In addition, the same base value was used to compute the pre-1989 RDA base revenue factor in the unitary and operating nonunitary apportionment system. The methodology used by the county understated the pre-1989 RDA revenue in the AB 8 system and overstated the revenue in the unitary and operating nonunitary apportionment system.

Requirements for the apportionment and allocation of unitary and operating nonunitary property taxes are found in *Revenue and Taxation Code* Section 100.

Unitary properties are those properties on which the Board of Equalization "may apply the principle of unit valuation in valuing properties of an assessee that are operated as a unit in the primary function of the assessee" (i.e., public utilities and railroads). The *Revenue and Taxation Code* further states, "Operating nonunitary properties are those that the assessee and its regulatory agency consider to be operating as a unit, but the board considers not part of the unit in the primary function of the assessee."

In FY 1988-89, the Legislature established a separate system for apportioning and allocating unitary and operating nonunitary property taxes. The unitary and operating nonunitary base year was established and formulas were developed to compute the distribution factors for the fiscal years that followed.

Recommendation

The county must remove the unitary and operating nonunitary assessed values from the AB 8 system and proportionately allocate the amount to the participating jurisdictions prior to computing these jurisdictions' base factors in the unitary and operating nonunitary apportionment system. The base factor for the pre-1989 RDAs in the unitary and operating nonunitary apportionment system should be computed using the RDA's unitary and operating nonunitary increment. Once these errors are corrected, the county should compile the differences and make necessary revenue adjustments in the current fiscal year.

County's Response

Your draft audit report contains one finding and recommendation pertaining to the unitary and operating non-unitary apportionments. We respectfully disagree with the audit finding on the unitary tax

apportionment for the following legal reasons and practical considerations. First, the audit finding that the pre-1989 redevelopment base must be reduced is not supported by state statute. Second, the State Controller's Office has previously approved the methodology used by Santa Clara County since the 1989 AB 454 implementation. Third, the differences in property tax apportionment in the methodology used by the County and that recommended in the draft audit report is immaterial. Finally, the State Controller's recommendation to recalculate tax apportionments would result in an undue hardship for the County with no corresponding benefit. Each of our comments on the draft audit report is discussed in detail below.

Audit Finding Not Supported By State Statutes

The draft audit finding that the pre-1989 redevelopment base must be reduced, and that the County incorrectly apportioned property taxes through the AB 8 apportionment system and the unitary apportionment system, is not supported by state code. The basis for the finding is that the County did not remove the unitary and operating nonunitary property in the pre-1989 redevelopment (RDA) base. Rather, the County kept the unitary property in the pre-1989 RDA base frozen--this resulted in a greater amount of property tax dollars apportioned to RDAs through the unitary system but an equal reduced allocation through the AB 8 system. The County's methodology used to implement the changes in unitary roll apportionments is consistent with state law and the intent of the AB 454 legislation.

The division and allocation of property taxes for redevelopment agencies is described in Health and Safety Code Section 33670 and defines the RDA base. Health and Safety Code Section 33670(a) describes the RDA base as "the total sum of the assessed value of the taxable property in the redevelopment project as shown upon the assessment roll used in connection with the taxation of that property by the taxing agency, last equalized prior to the effective date of the ordinance." Health and Safety Code Section 33670(a) establishes the RDA base as the total assessed value last equalized prior to the effective date of the ordinance. The Health and Safety Code governing redevelopment areas does not define the RDA base as comprised of various classifications of property tax rolls subject to change. Furthermore, it does not authorize a reduction in the RDA base for the change in the unitary apportionment process.

The draft audit report states that the requirements for the apportionment and allocation of unitary and operating non-unitary property taxes are found in Revenue and Taxation Code Section 100. This states in part: "... each taxing jurisdiction shall be allocated an amount of property tax revenue equal to 102 percent of the amount of the aggregate property tax revenue it received from all unitary and operating nonunitary property in the prior fiscal year." The Revenue and Taxation code does not explicitly reference or supersede Health and Safety Code Section 33670. Moreover, it does not alter the statutory computation of the RDA base or provide authorization to reduce the pre-1989 RDA base.

Revenue and Taxation Code Section 100 can be reasonably interpreted to mean that the total assessed value from all unitary and operating non-unitary attributable to RDA (not reducing the total assessed value last equalized prior to the effective date of the RDA ordinance, as prescribed by Health and Safety Code Section 33670 as the RDA base)

is the amount to be apportioned to RDAs through the unitary apportionment system. In fact, we believe that Santa Clara County's interpretation is consistent with the language of the AB 454 legislation.

The County treated the unitary value as negative increment in the affected tax rate areas and positive increment for the affected jurisdictions on the unitary roll. Consequently, there was a dollar for dollar transfer of tax from the secured roll to the unitary roll. The County fulfilled its statutory obligation under Revenue and Taxation Code Section 100 that all taxing jurisdictions receive 102 percent of the aggregate property tax from unitary and non-unitary property in the prior fiscal year.

The Results Of Both Allocation Methods Are The Same

We also disagree with the draft audit finding because the difference in methodologies between the County and the State Controller audit is immaterial. Although the County's methodology is different than that recommended by the draft audit report, the final result is the same. No taxing jurisdiction's net tax allocation revenue was affected.

The audit finding states that since the pre-1989 RDA base was not reduced the pre-1989 RDA revenue in the AB 8 system is understated and the revenue in the unitary and operating non-unitary apportionment system is overstated. In fact the difference in the initial reallocation from the AB 8 to unitary system is a dollar for dollar exchange in the respective property tax rolls. In fiscal year 1989, the exact dollar amount for RDAs' 1988 unitary base that the State Controller's Office states should have been apportioned through the AB 8 process was instead apportioned through the unitary apportionment system. But the total property tax apportionment for RDAs remained unchanged.

There is a difference in the calculation of tax increment growth. For the AB 8 process, revenue growth is allocated based on the increase/decrease in specific tax rate areas. For the unitary process, growth for the first two percent is allocated proportionate of the prior year distribution to the total and the excess of two percent is allocated by AB 8 factors. By reducing the pre-1989 RDA base, the growth on that RDA base reduced amount would be allocated to other non-RDA jurisdictions. That conflicts with the intent of the AB 454 legislation and the allocation of tax increment per Health and Safety Code Section 33670. That said, we emphasize that the differences in methodology are immaterial.

State Controller Approval of Santa Clara County Allocation Methodology

We were surprised with your draft audit finding because the methodology used by Santa Clara County was previously accepted by the State Controller's Office. The County of Contra Costa uses the same methodology and has passed State Controller audits since the implementation of the AB 454 legislation. The former Contra Costa auditor-controller served on the committee which drafted the AB 454 legislation and also served as a trainer for the three training sessions held in the cities of Redding, Modesto, and Ontario to educate counties on the changes made by AB 454. The State Controller's Office also served on the committee which drafted the AB 454 legislation and was a co-sponsor of the training sessions. The audit manager of the property tax apportionment audit program also served as a trainer. The different

methodologies, including the one used by Santa Clara County, were discussed during those training sessions. Significantly, the State Controller's Office did not object to their usage. The State Controller gave implicit approval for the usage of the two different methodologies. The basis for using the methodology for the 12-year tax allocation reconstruction we completed was this apparent approval by the State Controller and the interpretation of the Health and Safety Code.

Changing The Allocation Calculations Would Result In An Undue Burden On The County

The change in property tax apportionment computations recommended in the draft audit report would create an undue hardship for the County of Santa Clara. The County recently reconstructed 12 years of property tax apportionments as required by state law. The reconstruction was a three-year project involving thousands of staff hours and well over one million calculations. The County, after many meetings with our taxing entities, reached agreements with all agencies on the final reconstruction and any adjustments for past incorrect apportionments. An effort similar to that reconstruction project would be required to make the adjustments recommended in the audit report. Still, the net result of that effort would be little or no change to the prior tax allocations. We do not believe that any local government, the taxpayers of Santa Clara County and the State Controller will be better served by requiring such a laborious effort for so little results in return.

In conclusion, the California property tax apportionment laws and applications are complex and sometimes confusing. Counties may, in some cases, interpret the tax allocation requirements differently. The variations result from differing reasonable interpretations of state tax code. Santa Clara County's final apportionment of property tax dollars is in compliance with the intent of state legislation. The finding and recommendation in the draft audit report is a case where two methodologies can 1) be supported by state code 2) there are no material differences in the results from either methodology 3) the County's methodology has been approved by the State Controller, and 4) the audit finding does not warrant the expenditure of limited time and resources for no change to the end result.

Thank you for your consideration of these comments. The County of Santa Clara respectfully requests that the draft audit finding be modified to reflect the above issues and that the recommendation be changed to remove the recalculation of tax allocations. **If you do not modify the draft audit report, please include this letter as part of the final audit report.**

SCO's Comment

We continue to disagree with the county's methodology and the position that there is no legal basis to adjust the base for redevelopment projects as established by *Health and Safety Code* Section 33670(a). *Revenue and Taxation Code* Section 100 states, "Notwithstanding any other provision of law. . . ." In other words, this means without regard to other provisions of law, do the following. The section then goes on to describe how unitary and operating nonunitary revenues are to be allocated including in paragraph (a):

Each county shall establish one countywide tax rate area. The assessed value of **all** unitary and operating nonunitary property shall be assigned to this tax rate area. No other property shall be assigned to this tax rate area. (Emphasis added)

Paragraph (a) refers to all unitary and operating nonunitary property, not all such property except for that property in the area of redevelopment agencies.

The county further contends that the results of the two allocation methodologies are not significantly different. However, whether or not the results are similar is not relevant. The Legislature has prescribed certain methodologies in statute which the county did not follow.

However, because the county has secured the concurrence of the local agencies with its reconstruction, and because local agencies are able to negotiate exchanges of property tax revenues between themselves, the SCO, while continuing to disagree with the county, will take no further action on this matter.

Stanislaus County (July 1, 1999, through June 30, 2003)

Follow-up on Prior Audit Findings

Findings noted in our prior audit report, dated December 29, 2000, have been satisfactorily resolved by the county.

FINDING 1— Supplemental property tax

The supplemental property tax apportionment factor calculation included factors for unitary, operating nonunitary, redevelopment agencies, and redevelopment agency pass-through.

The legal requirements for supplemental roll property tax apportionment and allocation are found in *Revenue and Taxation Code* Sections 75.60 through 75.71 and 100.2. When there is a change in assessed property value due to changes in ownership or completion of new construction, the property owner is charged a supplemental property tax. This process enables the counties to retroactively tax property for the period when changes in ownership or completion of new construction occurred, rather than at the time the secured roll is developed.

Recommendation

The supplemental property tax apportionment factors should be corrected by excluding the items listed above.

County's Response

We agree with the finding. The county's new property tax system (MPTS 2000+) automatically addresses the issue of inclusion of unitary in the calculation of supplemental factors in that there is a segregation of the two rolls in the AB8 module of the system. The apportionment factors are now further modified to exclude redevelopment agencies and redevelopment agency pass-through. We also, as prescribed by law, modify the apportionment factors for school agencies to reflect the requirement that supplemental tax revenues be apportioned by ADA factors.

We have modified our 2003/2004 and 2004/2005 supplemental factors as indicated above and these adjusted factors are being used to apportion supplemental collections. Since we allocate all prior year supplemental with one set of factors (the last prior year supplemental apportionment factors) there is no need to make adjustments in factors for years prior to 2003/2004.

Schedules of our 2003/2004 and 2004/2005 supplemental apportionment factors and their corresponding worksheets are available upon request.

FINDING 2— Redevelopment agencies

The ERAF was included in the allocation of the redevelopment agency pass-through. The ERAF amount was then distributed to schools.

Requirements for the apportionment and allocation of property tax to RDAs are found in *Revenue and Taxation Code* Sections 96.4 and 96.5. California Community Redevelopment Law generally entitles a community redevelopment agency to all of the property tax revenues that are realized from growth in values since the redevelopment project's inception.

Recommendation

Since the ERAF is not considered an affected taxing entity, it should be excluded from the redevelopment agency pass-through allocation.

County's Response

We assume that this finding is in reference to the so-called AB1290 redevelopment agencies of which increment distribution is delineated in section 33607.5 of the Health and Safety Code. In implementing those provisions we followed guidelines developed by the Tax Managers Sub-Committee of the California Auditor's Association. Quoting from page 5 of the summary of those guidelines:

"A major shortfall of the provisions of Section 33607.5 is how ERAF is or is not treated when calculating the pass through amount due each taxing agency. In studying the provisions of this Section and also R&T 97.4 (which controls the distribution of ERAF) the following conclusion was reached:

ERAF will participate in the pass through calculations in the same manner as taxing jurisdictions and receive a proportionate share based on its AB 8 TRA factors. The pass through amount for ERAF will then be distributed to the affected schools in the same proportion that ERAF is distributed.

In Ventura County¹ the distribution of ERAF is summarized below:

K-12	81.941%
Community College	3.555
Supt of Schools	<u>4.504</u>
Total	100.00%

By implementing this procedure each school fund will fully benefit from the apparent underlying intent of mitigating the RDA impact while excluding a portion of the pass through from being defined as

property taxes, which benefits the local schools rather than the State. Also, this approach complies with the intent of AB 860 by limiting the impact on ERAF from RDA tax increments to future tax growth while continuing to receive its base year tax allocation.”

Based upon the above, we agree with the finding but contend no correction in our methodology is necessary since it appears to be in compliance with the guidelines and consequently in compliance with State law.

I The guidelines contained examples and calculations based upon an AB1290 redevelopment project in Ventura County. The applicable numbers in Stanislaus County are K-12 at 86.9102% and Community College at 13.0898%

SCO's Comment

The SCO legal counsel has opined that the ERAF is not an affected taxing agency because it cannot levy a tax rate. The finding remains as written.

Tehama County (July 1, 1999, through June 30, 2004)

Follow-up on Prior Audit Findings

Findings noted in our prior audit report, dated October 31, 2000, have been satisfactorily resolved by the county.

Conclusion

Our audit disclosed that the county complied with California statutes for the allocation and apportionment of property tax revenues for the period audited.

Ventura County (July 1, 1999, through June 30, 2003)

Follow-up on Prior Audit Findings

Findings noted in our prior audit report, dated September 29, 2000, have been satisfactorily resolved by the county. As a result of the passage of SB 1096, the ERAF shift credit error that was noted in the prior audit has been resolved.

Conclusion

As a result of the passage of SB 1096 (Chapter 211, Statutes of 2004), Ventura County complied with California statutes for the apportionment and allocation of property tax revenues for the period of July 1, 1999, through June 30, 2003.

Copies of the audit reports referred to in this report may be obtained by contacting:

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